DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER: 98-0710
State Gross Retail Tax – Lease of Tangible Personal Property
For Tax Years 1988 through 1997

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superceded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

State Gross Retail Tax—Lease of Tangible Personal Property

Authority: IC 6-2.5-1-2; IC 6-2.5-2-1; IC 6-2.5-4-10
IC 6-8.1-5-2; IC 6-2.5-8-8
45 IAC 2.2-4-27; 45 IAC 2.2-8-12

Taxpayer protests assessment of sales tax on receipts it received from its sister corporation that the Audit Division characterized as receipts from the leasing of equipment.

STATEMENT OF FACTS

Taxpayer is an S corporation which was created for the sole purpose of holding front-end loaders, fuel tanks, storage trailers, trucks, radios, office and other equipment for its sister corporation. Both taxpayer and its sister corporation are commonly owned. It is unclear whether the equipment was purchased originally by taxpayer's sister corporation or by taxpayer. However, it has been established that neither entity paid sales tax on the equipment at the time of the original purchase of the equipment. After performing the audit, the auditor determined that taxpayer was a lessor of equipment to its sister corporation, and was required to collect sales tax on the receipts taxpayer received from the "leasing" of equipment to its sister corporation. The auditor assessed sales tax liability for the years 1988 through 1997 based on her finding that taxpayer failed to file sales tax returns for the tax years in question. Taxpayer protests the assessment of sales tax.

State Gross Retail Tax—Lease of Tangible Personal Property

DISCUSSION

Taxpayer argues that sales tax should not have been assessed on what the auditor characterized as leasing receipts because taxpayer is not acting as a lessor of equipment to its sister corporation. According to taxpayer, the substance of the transaction is that taxpayer exists for the sole purpose of holding the equipment and making loan and equipment payments for its sister corporation. Taxpayer maintains that the loans used to purchase the equipment were executed jointly by taxpayer and the sister corporation, and that taxpayer's sister corporation purchased the equipment for use in its business. Based upon taxpayer's assertions, the question before us is whether a leasing arrangement exists between taxpayer and its sister corporation.

"An excise tax, known as the state gross income tax, is imposed on retail transactions made in Indiana." IC 6-2.5-2-1(a). A "retail transaction" is defined in IC 6-2.5-1-2 as "a transaction of a retail merchant that constitutes selling at retail." "A person . . . is a retail merchant making a retail transaction when he rents or leases tangible personal property to another person." IC 6-2.5-4-10(a). In general, the gross receipts from renting or leasing tangible personal property are taxable. 45 IAC 2.2-4-27. This regulation only exempts from tax those transactions which would have been exempt in an equivalent sales transaction. *Id*.

Although taxpayer and its sister corporation are one hundred percent (100%) owned by the same entity, we find that taxpayer is a separate legal entity formed for the sole purpose of leasing equipment to its sister corporation. The law imposes sales tax upon an entity when it rents or leases tangible personal property to another. 45 IAC 2.2-4-27. Upon completing the audit, the auditor imposed sales tax on all of the equipment leased by taxpayer to its sister corporation except for the equipment that the auditor determined was used directly in the sister corporation's manufacturing process. There is no doubt that sales tax should be imposed on the receipts from the lease transactions between taxpayer and its sister corporation. The auditor did not err in imposing the assessment.

Because we find that taxpayer and its sister corporation enjoyed a leasing arrangement, we now turn to taxpayer's alternate argument. Taxpayer argues that it is relieved of its burden to collect and remit sales tax on the rental of the equipment to its sister corporation because the sister corporation provided a valid sales tax exemption certificate covering the transactions in question. Furthermore, according to taxpayer, because the sister corporation filed sales tax returns for the tax years 1988 through 1997, any sales tax due would be subject to the three-year statute of limitations and not open to an extended examination period applicable where a taxpayer fails to file tax returns.

The issuance and effect of exemption certificates are covered under IC 6-2.5-8-8, which provides the following:

> (a) A person, authorized under subsection (b), who makes a purchase in a transaction which is exempt from the state gross retail and use taxes, may issue an exemption certificate to the seller instead of paying the tax. The person shall issue the certificate on forms and in the manner prescribed by the department. A seller accepting a proper

> exemption certificate under this section has no duty to collect or remit the state gross retail or use tax on that purchase.

IC 6-2.5-8-8(a). "An exemption certificate issued by a purchaser shall not be valid unless it is executed in the prescribed and approved form and unless all information requested on such form is completed." 45 IAC 2.2-8-12(f).

The time limitation on issuance of a proposed assessment is governed by IC 6-8.1-5-2 which provides in pertinent part:

> Except as otherwise provided in this section, the department may not issue a proposed assessment under section 1 of this chapter more than three (3) years after the latest of the date the return is filed, or any of the following:
>
> > (1) the due date of the return; or
> >
> > (2) in the case of a return filed for the state gross retail or use tax . . . the end of the calendar year which contains the taxable period for which the return is filed.
>
> . . .
>
> (e) If a person files a fraudulent, unsigned, or substantially blank return, or if a person does not file a return, there is no time limit within which the department must issue its proposed assessment.

IC 6-8.1-5-2.

After taxpayer's protest hearing, taxpayer remitted to the hearing officer a copy of the exemption certificate given by the sister corporation to taxpayer. The exemption certificate is dated November 11, 1999, and states that it exempts from sales tax the "rental of equipment used in the mining operation, 1988 through 1998." The exemption certificate presented here is dated after the close of the tax period subject to audit. In fact, the exemption certificate is dated after the completion of the audit, after the date of hearing, and most importantly, after almost all of the periods at issue had been closed to assessment for the sister corporation. The issuance of an exemption certificate after the fact does not in and of itself negate its effect. However, when it is issued up to twelve (12) years after the transaction, its efficacy should be in doubt. In this case, the auditor only taxed that portion of the taxpayer's receipts as would have been taxable to the sister corporation. Therefore, the taxpayer has received the benefit of not being taxed on its entire gross retail income. That is as much benefit as should be allowed in this case pursuant to 45 IAC 2.2-8-12, which allows the taxpayer to prove what level of exemption would have been allowed to its customer if there is a question as to the proper execution of an exemption certificate. The evidence on file also reveals that taxpayer was not registered with the Department to collect Indiana sales tax for its rental of equipment.

Furthermore, a review of the audit documentation shows that during the audit period, on their respective tax returns, taxpayer's sister corporation claimed a rental expense deduction, and taxpayer claimed a depreciation allowance for the equipment. Taxpayer and its sister corporation were established with and continued to maintain separate legal identities. Having taken on the advantages of separate corporate structures, taxpayer may not then avoid the consequences of its business relationships and transactions.

FINDING

Taxpayer’s protest is denied. The auditor did not err in finding that taxpayer and its sister corporation enjoyed a leasing arrangement and assessing sales tax in the absence of a valid exemption certificate.

HLS/MR – 011312